



Michigan *Office of the Auditor General* **REPORT SUMMARY**

Performance Audit

Individual Income Tax Return Processing

Department of Treasury

Report Number:
271-0230-05

Released:
January 2007

In 1967, the Michigan Legislature approved Act 281, P.A. 1967, the Income Tax Act (Sections 206.1 - 206.532 of the Michigan Compiled Laws), which prescribed a State tax on personal income. The Department of Treasury's Return Processing Division (RPD) administers the Act. RPD is responsible for collecting and processing individual income tax (IIT) returns; correcting or disallowing questionable or erroneous IIT returns; initiating letters of inquiry and explanation to taxpayers; initiating assessments for IIT deficiencies, penalty, and interest; and issuing refunds for IIT overpayments.

Audit Objective:

To assess the Department's effectiveness in using data available from external sources to identify unreported IIT and initiate assessments in a timely manner.

Audit Conclusion:

We concluded that the Department's use of data available from external sources to identify unreported IIT and initiate assessments in a timely manner was not effective. Our assessment disclosed two material conditions (Findings 1 and 2).

Material Conditions:

RPD had not established a comprehensive system of automated data comparisons to sufficiently validate the accuracy of certain income tax deductions claimed by taxpayers on their Michigan IIT returns. Also, RPD did not use all of the procedures available within its current system of automated data comparisons to validate the reasonableness of income tax deduction amounts claimed by taxpayers on their IIT returns. As a result, RPD could not ensure the propriety of significant State income tax deductions claimed by

taxpayers for tax years 2001 through 2004. (Finding 1)

RPD did not consistently utilize its process to identify taxpayers who failed to file annual returns or who did not remit the appropriate IIT as required by the Income Tax Act. As a result, the State incurred a potential loss of income tax revenue totaling at least \$10.2 million from nonfilers for one tax year and a cumulative \$9.5 million from underreporters for three tax years within our audit period. (Finding 2)

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Audit Objective:

To assess the effectiveness of the Department's efforts to ensure that it processed IIT returns in an accurate and timely manner.

Audit Conclusion:

We concluded that the Department's efforts to ensure that it processed IIT returns in an accurate and timely manner were moderately effective. We noted reportable conditions related to penalties

and interest for late returns, refund interest, penalties and interest for underpayment of estimated tax, manually reviewed refund approvals, limited review of returns, and two-dimensional (2-D) bar-coded return management control (Findings 3 through 8).

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Agency Response:

Our audit report includes 8 findings and 11 corresponding recommendations. The Department's preliminary response indicates that it agrees with 10 of the recommendations and partially agrees with 1 recommendation.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General